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No. 93-

IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

SANFORD REDMOND, INC.,
Petitioner,

v.

MID-AMERICA DAIRYMEN, INC.,
Respondent.

On Petition for a Writ of Certiorari to the United States Court of Appeals For the Second Circuit

PETITION FOR A WRIT OF CERTIORARI

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August 1993

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QUESTIONS PRESENTED

1. If a district court invalidates the rental provision of a lease of a patented machine on the ground that the rental payments violate the rule of Brulotte v. Thys Co., 379 U.S. 29 (1964), must the court declare all other provisions of the lease unenforceable?

2. Is an agreement to pay rent on the lease of a patented machine based on the volume of the lessee's use of the machine invalid under Brulotte v. Thys Co., supra, merely because the same rate applies both before and after expiration of the patent?

3. Should Brulotte v. Thys Co., supra, be overruled to the extent that it establishes a per se rule invalidating all post-expiration payments relating to a patented machine?

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OPINIONS BELOW

The decision of the court of appeals (Appendix A, pp. 1a-2a, infra), is reported at 993 F.2d 1534 (2d Cir. 1993). The decision of the district court (Appendix B, pp. 3a-24a, infra) is unreported.

JURISDICTION

The decision of the Court of Appeals for the Second Circuit was rendered on April 27, 1993. On July 7, 1993, Justice Thomas extended the time for filing a petition for a writ of certiorari to and including August 25, 1993 (Appendix C, p. 25a, infra). The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATEMENT

1. Introduction

Butter or margarine is customarily served in restaurants in single-serving pats on cardboard covered by grease-proof parchment paper. Petitioner ("Redmond") is a family corporation in the business of manufacturing and leasing machines that convert bulk butter and margarine into complete packaged serving units. The models at issue in this litigation produced 1500-1800 such pats per minute. The current president and CEO of Redmond developed a machine called "REDDIES" that not only sandwiches butter pats between cardboard and parchment, but in its "Automatic Model" also counts and loads the units into trays. The machines involved in this case contain more than 2000 moving parts. They are approximately 6½ feet long and weigh between 1500 and 2400 pounds (A. 94-96). [1] Their construction involves confidential proprietary information and trade secrets.

2. Rental of the Machines

Petitioner has always, with "very rare exceptions," followed the practice of leasing its machines (A. 104-105). Lessees were charged a nominal fixed monthly rental for use of the machines ($175 per month in this case) and were required to pay a rental based on the quantity of butter converted to single servings by the machine. The respondent's rental fee was 1.85 cents per pound of butter or

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[1] "A." indicates the Joint Appendix filed in the court of appeals.

margarine used in the leased machine, with a minimum of 480,000 pounds per year.

The machine leases did not refer to any patent rights, and the vice president of the lessee who negotiated the leases involved in this case acknowledged that patents and patent rights were never mentioned during the lease negotiations. He testified (p. 30a, infra):

> I don't know of any reason why I would care whether they had patents or not on the thing. I was only concerned about what the machine would do and the poundage it would produce and how much it cost me to run it.

The lease was a conventional equipment rental agreement that contained standard leasing clauses. Among the "covenants" of the lessee was the following (A. 439; emphasis added):

> (B) To keep the Machine in good repair and good operating condition at all times during the continuance of this Agreement & Lease; to use as replacement parts on the Machine only parts approved by Lessor and to have repairs and replacements of parts made only by persons, firms or corporations approved by Lessor; not to alter, tamper, experiment with, nor place any device or attachment on the Machine or copy or knowingly permit anyone else to copy, study, or examine the Machine in part or whole and to take all necessary precautions to prevent any such violations; not to remove, injure or alter any plate or mark placed on the Machine; . . .

Another paragraph of the lease declared (A. 443):

> (K) This Agreement & Lease and the rights of the parties hereunder shall be governed by and interpreted in accordance with the laws of the State of New York. The invalidity of any of its provisions shall not affect the binding effect of the other provisions hereof.

3. The Beatrice Leases

Seven-year leases of "REDDIES" machines containing these provisions were concluded with Beatrice Foods Co. in April 1980. On August 1, 1983, following the purchase of Beatrice's Russelville, Arkansas, plant by respondent ("Mid-America"), a farm cooperative with annual revenues exceeding one billion dollars (A. 27), Mid-America was assigned the leases. In October 1983 Mid-America stopped making rental payments. It also made the leased machines available, in violation of the "covenant" in the lease, to a design firm that copied the trade secrets and other proprietary and confidential information in order to manufacture a competing machine.

4. Applicable Patents

Patents have been issued on various models and components of the "REDDIES" machine. An early model, completed in 1956, was the subject of a patent issued in April 1964. The Automatic Counter and Tray Loader was also the subject of a patent issued in 1972.

5. Litigation

In June 1985, petitioner sued Mid-America in the United States District Court for the Southern District of New York for the rentals due under the lease and for breach of the lessee's covenant. With regard to the latter claim, the parties signed a four-page Stipulation of Facts that appears as Appendix D to this petition (pp. 26a-32a, infra).

After a trial, District Judge Robert J. Ward held that the leases were "at least an implied patent license" and, accordingly, that the receipt of rental payments for use of the "REDDIES" machine violated the per se rule of Brulotte v. Thys Co., 379 U.S. 29 (1964). The court then turned to the severability clause and held that since the agreement was "unlawful per se" under Brulotte, the "entire contract," including the "no-copying clause," was unenforceable. Judge Ward said that this was "the law in this district" (p. 22a, infra). He ruled that once the patent expired "the only obligation which remained was the obligation to return the machines to Redmond" (p. 23a, infra). The court of appeals affirmed on the district court's opinion.

REASONS FOR GRANTING THE WRIT

1. Invalidation of the Entire Lease Conflicts With This Court's Decision and With the Rulings of Other Courts of Appeals.

Judge Ward's declaration that "the entire contract" is unenforceable because the rental payments are "unlawful per se" under Brulotte (p. 22a, infra) conflicts with this Court's explicit language in Brulotte and with the results in other post-Brulotte cases. The court of appeals apparently agreed with the district court's conclusion that the law had been clearly established in the Second Circuit's ruling in Glen Mfg. v. Perfect Fit Indus., 420 F.2d 319 (2d Cir.), cert. denied, 397 U.S. 1042 (1970). Consequently, the court of appeals affirmed without opinion.

The Second Circuit's rule conflicts, however, with what this Court explicitly said in Brulotte and with what other courts of appeals have done in cases in which they have determined that licensing clauses were illegal under Brulotte. When this Court concluded in Brulotte that a license agreement accompanying the sale of a patented machine was an illegal attempt to project a monopoly beyond the patent period, it reversed a judgment for the patent-holder "insofar as it allows royalties to be collected which accrued after the last of the patents incorporated into the machines had expired." 379 U.S. at 30. The Court did not invalidate the entire license agreement. [2]

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[2] "Insofar as" is defined as "to the extent or degree as." Webster's Third New Int'l Dictionary 1170 (1971).

Nor did the Sixth, Seventh and Eleventh Circuits invalidate the entire agreements before them in Boggild v. Kenner Prods., 776 F.2d 1315 (6th Cir. 1985), cert. denied, 477 U.S. 908 (1986); Meehan v. PPG Indus., 802 F.2d 881 (7th Cir. 1986), cert. denied, 479 U.S. 1091 (1987); and Pitney Bowes, Inc. v. Mestre, 701 F.2d 1365 (11th Cir.), cert. denied, 464 U.S. 893 (1983). In each of these cases, only the clause that prescribed payment of amounts found to be post-expiration royalty payments was invalidated.

The leading study of patent licensing squarely disagrees with the decision of the courts below in this case. In his essay on Patent Licensing Transactions, in 14 Business Organizations at 7-68 (MB 1993) (footnote omitted) Professor Harold Einhorn says:

> Post expiration royalty provisions of a licensing agreement, when constituting a misuse, are generally held to be severable from the agreement. Thus, while the offending clauses are held to be unenforceable, they do not invalidate the entire agreement.

On the facts of this case, the ruling of the courts below is particularly unsound. Even if — contrary to our contention below (pp. 10-11, infra), — a court could validly conclude that the patent laws prohibit collecting the same rental both before and after expiration of a patent, it is indisputable that a valuable machine belonging to Redmond was provided to Mid-America for its use. The remainder of the lease that the district court invalidated concerned not only restrictions against copying trade secrets, but also specified the degree of care that Mid-America was to exercise in repairing and maintaining the machine. In addition, it

obligated Redmond to supply parts and service promptly and, therefore, to maintain a significant inventory of parts and a staff of qualified service engineers. Because of Brulotte, federal patent law may require that specific provision be made in the lease for a reduced rental after the expiration of a patent. But if the parties fail to provide such a reduction, Mid-America is not entitled to abuse or damage the leased machine. Nor should it be entitled to disassemble the machine or otherwise to violate its trade secrets and confidential proprietary information in order to compete with Redmond.

This Court has not been reluctant explicitly to invalidate entire contracts when federal policy has justified so drastic a remedy. In Katzinger Co. v. Chicago Metallic Mfg., 329 U.S. 394 (1947), royalty provisions of a patent licensing agreement were invalidated because they were an "integrated companion" of a price-fixing provision in the agreement. 329 U.S. at 401. See also MacGregor v. Westinghouse Electric & Mfg., 329 U.S. 402, 407 (1947) ("covenant to pay royalties was not severable from the covenant to sell at fixed prices"). In Brulotte the Court did no such thing. It invalidated only the requirement to pay the impermissible royalty. The courts below should have followed Brulotte.

Finally, the decision below has enormous consequences for the equipment leasing industry. When Mid-America purchased the facility of Beatrice, Redmond's original lessee, it searched for a way to avoid the leases Beatrice had signed. In a letter of October 31, 1983, Mid-America's vice-president of operations said: "Mid-America as well as Beatrice attorneys have examined the leases with hopes of finding a loop-hole but to no avail" (A. 534). Shortly thereafter, however, the legal argument that the

courts below have now upheld was apparently discovered. And it has led to total invalidation of the lease agreements.

The Second Circuit's decision will have an enormous and disruptive impact on the equipment leasing industry. Owners and manufacturers of machines containing even a single patent will no longer be able to offer long-term, fixed-rate equipment leases. Instead, equipment owners will be required to charge one rate during the term of the license and a lower rate upon expiration of the patent regardless of the economic reality of the transaction. More importantly, the existence of an invalid royalty provision will now render entire leases and contracts unenforceable, including otherwise valid non-royalty contract provisions.

It takes little imagination to predict how the Second Circuit's decision will be exploited to affect many existing lease agreements that fall within the Second Circuit's holding. The unwarranted expansion of Brulotte by the Second Circuit could not have been reasonably predicted by counsel who drafted long-term lease agreements prior to the decision below. Thousands of long-term, fixed-rate equipment leases worth billions of dollars common in major U.S. industrial sectors — including the oil drilling, commercial aircraft, railroad cars, and heavy equipment industries, to name a few — may be nullified under the Second Circuit's decision.

Moreover, the effect of the holding is to permit lessees to violate commitments to keep proprietary information confidential and to protect trade secrets. As a result of the Second Circuit's decision, for example, Mid-America will not only avoid paying rent on the use of the "REDDIES" machine, but will be able to copy the machine

and its trade secrets without investing the time, money and effort needed to design a competing machine.

Equipment owners and other lessors who failed to anticipate the Second Circuit's extension of Brulotte face the prospect of having their leases nullified, including even clauses that have nothing to do with rental provisions. This was not, we submit, the intended reach of the Brulotte decision. Nonetheless, if the decision in this case remains an applicable precedent, thousands of equipment leases now in effect are jeopardized and may be set aside totally at the instance of sharp-eyed lessees.

2. The Courts Below Misapplied This Court's Decision in Brulotte.

By invalidating the rental provision and the remainder of the lease, the courts below engaged in an unprecedented and unwarranted extension of Brulotte. This is the first reported case, to our knowledge, in which Brulotte has been applied to declare unenforceable the provisions of a lease agreement, as contrasted with a sale or a transfer of patent and trade secret rights. The offending patent-holder in Brulotte sold his patented machine, thereby retaining no rights in the physical object other than those covered by the license agreement. This Court then declared that the royalty payment was a surreptitious means of extending the patent and was not, therefore, entitled to survive. In the present instance, however, Redmond retained ownership of the machine, which was provided to Mid-America for its use. Redmond was entitled to be compensated for the wear and tear on its machine and for its use. Even if customary per-pound fees may not be collected under the contract, Redmond is entitled to claim in quantum meruit for use of its

machine in processing butter and in making a duplicate machine of Redmond's own design to compete with Redmond.

The result reached by the courts below allows federal patent law to override rights that have been recognized by state law. This conflicts with Universal Gym Equip. v. ERWA Exercise Equip., 827 F.2d 1542 (Fed. Cir. 1987). This Court should review this case to determine whether rights to trade secrets and to a legitimate rental for use of a patented machine survived the Brulotte decision.

3. Brulotte Should Be Overruled.

Justice Harlan's dissenting opinion in Brulotte demonstrated how unjustified the inferences were in Justice Douglas' majority opinion. There are, as Justice Harlan indicated, many conceivable post-expiration use restrictions that are "clearly acceptable" and are no different, in substance, from the "license royalty" that the Court majority invalidated.

Justice Harlan's dissent noted that in selling a patented machine, a patent-holder "sells both a machine and the use of an idea." 379 U.S. at 35. One who leases a machine on which he holds a patent is plainly in the same category. Although he may not restrict use of the patented idea after it has come into the public domain, he is fully entitled to restrict physical use of his machine and to be compensated by anyone who is permitted to operate the machine.

In fact, the lease arrangement established in this record parallels a hypothetical arrangement which, Justice

Harlan noted, "would involve no misuse of patent leverage." 379 U.S. at 36 (footnote omitted). If the owner of a machine receives, as his "sole recompense" for making the machine available, a payment based on a lessee's use, he is not exercising the "patent leverage" that the Court sought to condemn in Brulotte. To the extent that Brulotte might be read as invalidating such a arrangement, it should be overruled.

This Court's rulings since Brulotte demonstrate the flaws of that 1964 decision. In Kewanee Oil Co. v. Bicron Corp., 416 U.S. 470 (1974), the Court held that local law may protect trade secrets that could qualify as patentable inventions. Hence the premise of Brulotte's rule of per se invalidity — i.e., that a license payment made after expiration of a patent is necessarily an improper payment extorted only because of the patent-owner's "leverage" — is no longer valid. Such a payment may, under Kewanee Oil, be entirely lawful consideration for use of a trade secret protected by state law.

And in Aronson v. Quick Point Pencil Co., 440 U.S. 257 (1979), this Court refused to apply Brulotte because its rule of per se illegality did not square with economic reality. Justice Blackmun, concurring separately, observed that the Aronson case could not readily be distinguished from Brulotte. 440 U.S. at 266. The majority acknowledged that the putative patent rights that were part of the agreement challenged in Aronson provided "additional bargaining power" for the royalty agreement. 440 U.S. at 265. But the Court rejected the argument that this possibility rendered the agreement unlawful per se.

The inflexible per se rule of Brulotte has been severely criticized by academic commentators. See, e.g., S.

Stephen Hilmy, Bonito Boats' Resurrection of the Preemption Controversy: The Patent Leverage Charade and the Lanham Act 'End Around,' 69 Tex L. Rev. 729 (1991 (per se rule is economically inefficient and easily evaded); Rochelle Dreyfuss, Dethroning Lear: Licensee Estoppel and the Incentive to Innovate, 72 Va. L. Rev. 677, 707-08 (1986) (footnote omitted) (commenting that it is "doubtful that the per se rule enunciated in Brulotte is good law after Aronson."). And this Court has recently recognized the inadequacies of per se rules of illegality affecting commercial relations. In Eastman Kodak Co. v. Image Technical Services, Inc., 112 S.Ct. 2072 (1992), the Court majority analyzed the precise economic consequences of an alleged tying arrangement before concluding that it could be found illegal after a full trial record. Justices Scalia, O'Connor and Thomas, in dissent, challenged directly the per se rule prohibiting tying arrangements that had been applied by this Court during the time when Brulotte was decided.

Justice Douglas' opinion in Brulotte relied significantly on the proposition that tying arrangements are invalid per se. He said (379 U.S. at 33):

> A patent empowers the owner to exact royalties as high as he can negotiate with the leverage of that monopoly. But to use that leverage to project those royalty payments beyond the life of the patent is analogous to an effort to enlarge the monopoly of the patent by tieing the sale or use of the patented article to the purchase or use of unpatented ones.

This foundation for the per se doctrine of Brulotte has been eroded by later decisions and by a more sophisticated appreciation of the economic consequences of tying arrangements. Accordingly, Brulotte should be re-examined and overruled.

CONCLUSION

For the foregoing reasons, a writ of certiorari should be granted.

Respectfully submitted,

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August 1993

APPENDIX

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

At a stated term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse in the City of New York, on the 27th day of April, one thousand nine hundred and ninety-three.

PRESENT:
HONORABLE GEORGE C. PRATT,
HONORABLE DENNIS G. JACOBS,
Circuit Judges.
HONORABLE WHITMAN KNAPP,
District Judge of the United States District Court for the Southern District of New York, sitting by designation.

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SANFORD REDMOND, INC.,
Plaintiff-Appellant,

- against -

MID-AMERICA DAIRYMEN, INC.,
Defendant-Appellee,

Docket No. 92-9302

----------x

MID-AMERICA DAIRYMEN, INC.,
Counter-Claimant,

- against -

SANFORD REDMOND, INC.,
Counter-Defendant.

----------x

This appeal from a judgment of the United States District Court for the Southern District of New York came on to be heard on the transcript of record and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now ordered, adjudged, and decreed that the judgment appealed from is hereby AFFIRMED, substantially for the reasons set forth in the Memorandum Decision of Judge Robert J. Ward, dated March 3, 1992.

/s/ George C. Pratt, U.S.C.J.

/s/ Dennis G. Jacobs, U.S.C.J.

/s/ Whitman Knapp, U.S.D.J.

APPENDIX B

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

----------x

SANFORD REDMOND, INC., :

Plaintiff, :

- against - : MEMORANDUM DECISION 85 Civ. 4574 (RJW)

MID-AMERICA DAIRYMEN, INC., :

Defendant, :

----------x

BACKGROUND

Plaintiff Sanford Redmond, Inc. ("Redmond") alleges that certain trade secrets which were incorporated in a patented machine that processed a portion controlled package of butter were misappropriated by defendant Mid-America Dairymen, Inc. ("Mid-America"). On February 6, 1991, this Court ordered bifurcation for trial on the issue of liability for misappropriation of trade secrets. Thereafter,

the Court ordered a further bifurcation, with the first trial to be on the issue of whether trade secrets of plaintiff were misappropriated into a substantially identical machine. In the event plaintiff were to prevail, a second trial would follow on the issue of whether defendant was responsible for the misappropriation.

Trial on the issue of whether trade secrets were misappropriated commenced on June 17, 1991. At the outset of the trial, defendant conceded all liability aspects to be adjudicated at that trial except for the issue of whether, under the totality of the circumstances, the protection that plaintiff afforded its trade secrets was adequate. On June 24 and June 25, 1991, a trial was conducted with respect to the adequacy of the protection afforded by plaintiff to its trade secrets.

At the conclusion of the testimony presented at that first trial, plaintiff moved to conform the pleadings to the proof and specifically to permit plaintiff to assert that defendant breached its contractual obligations to plaintiff

embodied within section III(B) of two lease agreements, the R-21 Lease and the R-61 Lease (hereinafter the "no copying provision").

On July 12, 1991 a written stipulation was entered into between the parties which was so ordered by the Court on July 15, 1991. The parties stipulated, inter alia, that:

> 1. Plaintiff's motion to amend the pleadings to conform to the evidence admitted at trial conducted on June 24, and June 25, 1991 is granted; and
>
> 2. Defendant's motion to continue the case pending the preparation and presentation on the fourth and ninth affirmative defenses is granted.

By subsequent agreement between the parties and the Court, the trial of the affirmative defenses asserted by Mid-America to plaintiff's b[r]each of contract claim pertaining to the "no copying provision" was continued to December 18, 1991.

Prior to the continued trial date of December 18, defendant abandoned its ninth affirmative defense that plaintiff had violated Section 4 of the Clayton Act and Section 2 of the Sherman Act. Instead, defendant proposed to limit its evidence to its fourth affirmative defense, that the "no copying provision" was an unenforceable and improper extension by plaintiff of a patent monopoly.

On December 18, in lieu of presenting evidence on plaintiff's breach of contract claim and defendant's fourth affirmative defense, the parties entered into Stipulated Findings of Fact, which were so ordered on that date by the Court. Decision with respect to plaintiff's trade secret claim which was the subject of the first trial, plaintiff's breach of contract claim, and defendant's affirmative defense to plaintiff's breach of contract claim pertaining to the "no copying provision" was reserved by the Court to permit the parties to submit written post-trial memoranda.

ISSUES TO BE DETERMINED

1. Did plaintiff afford adequate protection to its trade secrets?

2. Is the "no copying provision" embodied within the R-21 Lease and the R-61 Lease an unenforceable and improper extension by plaintiff of a patent monopoly?

Plaintiff's Trade Secret Claim

A trade secret must remain secret during the normal process of exploitation. When possession of a trade secret is released to a third party, as in the present case, reasonable measures must be taken by the owner of the trade secret to maintain secrecy. Defiance Button Machinery Co. v. C&C Metal Products, 759 F.2d 1053, 1063-64 (2nd Cir.) cert. denied, 474 U.S. 844 (1985).

Accordingly, the only issue to be determined with respect to plaintiff's trade secret claim is whether plaintiff afforded adequate protection to its trade secrets during the process of exploitation. In order to determine this issue, the Court must ascertain the degree of secrecy surrounding the

alleged secrets and plaintiff's efforts to preserve secrecy. The Court notes initially that to the extent plaintiff's trade secrets were the subject of a valid patent, those secrets were disclosed at the time the patent issued. Timely Products Corp. v. Arron, 523 F.2d 288, 304 (2d Cir. 1975) (citing Conmar Products Corp. v. Universal Slide Fastener Co., 172 F.2d 150, 155 (2d Cir. 1949)). Plaintiff contends, however, that its trade secrets include items not disclosed in its patent, such as technical and engineering information.

Jonathan Redmond, plaintiff's Executive Vice President, testified concerning plaintiff's efforts to prevent the disclosure of any trade secrets by its employees and others in connection with the manufacturing process. After describing the physical layout of plaintiff's premises and the means used to control ingress and egress, including the installation of an alarm system, he testified concerning the entry way configuration which limits access to the premises, via a buzzer system, only to those people who are cleared for

entry; that it was plaintiff's policy to require each visitor who enters the premises to sign a guest register; and that no visitor is permitted to walk through any part of the premises unescorted. In addition, he testified that access to the engineering area was restricted by a sign stating "Notice-Authorized Personnel Only."

Jonathan Redmond also described the procedure used for making parts. First a determination is made by a manager that a part or group of parts needs to be made. Once such a determination is made a numbered requisition form (called a traveler) must be completed by the manager and logged in a record book. The traveler is then delivered to the engineering department which provides the manager with a copy of the drawing for the part that needs to be manufactured, and upon which is placed the number of the traveler.

The manager then takes the drawing to the machine shop and delivers it to the foreman, who distributes it to the

proper machinist. Once the machinist finishes the part, he must sign the parts drawing and note the date and time of completion, and return it to the foreman. The foreman then brings the part and the drawing to the inventory department for inspection. At that point, an inspector inspects the part to make sure that it is in conformity with the drawing. The part itself is then stocked into inventory while the signed and numbered parts drawing is filed away within the inventory and inspection area. The inventory and inspection area is enclosed and locked and entry is permitted only by way of a buzzer system.

Jonathan Redmond also described the procedures used with respect to those parts which are manufactured by outside contractors. Plaintiff uses only two or three contractors to actually manufacture parts, although other contractors are hired on occasion to perform special machining, processing or finishing. Redmond informs the subcontractors of the secret nature of the business and of the necessity for the

subcontractors to maintain, within strict confidence, all proprietary information which is disclosed to them on an as needed basis. No parts drawings are given to those subcontractors who only perform such work as special machining, finishing or processing, which would not require access to parts drawings. Jonathan Redmond also described the procedures in place when a parts drawing is required to be given to a subcontractor. As described by Redmond, that procedure is basically the same procedure as followed with respect to in-house parts manufacturing, except that in lieu of a traveler a numbered purchase order is used. He also testified that the parts drawings have a legend imprinted on them which states that the parts shall not be duplicated or copies or any of the information on the drawing disclosed without the written consent of plaintiff.

In addition, he testified concerning procedures taken at trade shows to make certain that the dimensions and composition of parts are never disclosed, that metallurgical

testing of parts is not made, and that no measurements or photographs are taken of plaintiff's machines.

Jonathan Redmond and Vincent Salek, who is now plaintiff's Vice-President and Operations Manger, but who had been a service engineer who made service calls upon plaintiff's customers, testified that it was the policy of the plaintiff that no parts drawings would ever leave plaintiff's plant and that dimensions and materials were not to be disclosed to the lessees.

Sanford Redmond testified concerning the long-standing practice he had of stressing to all employees the need to maintain confidentiality. Specifically, Redmond testified that he made it a practice to interview each and every employee either prior to or at the time of hiring to impress upon them the need to maintain confidentiality and secrecy about all aspects of plaintiff's business. In addition, all employees were required to sign confidentiality agreements which agreements were renewed every three or

four years. Finally, Redmond testified that it was plaintiff's "absolute policy" not to supply customers with any parts drawings or with the dimensions or composition of individual parts.

The Court concludes that plaintiff made adequate efforts to preserve secrecy in connection with the manufacturing and servicing of the machines.

However, apparently relying on the no copying provision in the leases except for not disclosing the dimensions or composition of parts and not providing scaled drawings to lessees, plaintiff did nothing extraordinary to maintain secrecy after the machines were delivered to lessees.

For example, although the placards on the machines warn that they are "Patented," the placards do not warn that the machines contain trade secrets. Although initially placing confidentiality legends on the assembly drawings furnished to

lessees, plaintiff abandoned placing such legends on the materials.

Also, Redmond does not require that lessees physically isolate the machines in their plants, or that detailed knowledge of the machine be restricted to "need to know" employees. Plaintiff sells replacement parts for the machines outright, and places no control on these parts whatsoever, such as serialization and required return of used parts. There is no requirement that the lessee's employees sign confidentiality agreements concerning the machines.

Nor has Redmond ever had a program of auditing the performance of its lessees. Finally, although most machines were leased, Redmond also sold three of the machines, many years ago, thereby passing the machines' trade secrets into the public domain.

After considering the totality of the circumstances, including plaintiff's evidence of internal controls, the Court concludes that Redmond failed to afford adequate protection

to its trade secrets in the leased machines. Rather than following policies similar to those employed in connection with the manufacturing and servicing of the machines, plaintiff elected to rely on the no copying provision in the leases.

Plaintiff's Contract Claim

The material facts on which plaintiff's contract claim and defendant's fourth affirmative defense are based are set forth in the following stipulation between plaintiff and defendant:

> On April 21, 1964 plaintiff Redmond obtained a patent on a machine that processed "Reddies", a portion controlled package of butter or margarine (the " '546 patent"). As far as the Court has been made aware, all Reddies type packages of butter produced by mechanized means were processed on machinery manufactured by Redmond until approximately 1985.
>
> According to Sanford Redmond, no patent has ever been applied for or obtained on the Reddies package nor has any trademark for said package ever been applied for or registered by plaintiff.

Sanford Redmond also states that the cost of manufacturing the "R" series machine in 1980 was approximately $200,000.

Plaintiff has made the Reddies processing machines available, with certain very rare exceptions, under a lease. The monetary and no inspection, no copying terms and conditions of the lease, inter alia, are essentially non-negotiable. Each lease contained a provision requiring the lessee to pay a fixed monthly rental and an additional fixed sum for each pound of butter or margarine processed by the lessee with the leased machine ("poundage rental"). In addition, some of the leases make reference to a minimum poundage rental.

All leases contained substantially similar provisions prohibiting lessees from copying or knowingly permitting anyone else to copy, study or examine the leased machine in whole or in part, to take all necessary precautions to prevent any such violations.

The leases between plaintiff and the Sugar Creek Foods Division of Beatrice Foods Co. ("Beatrice") which defendant assumed in August 1983 after the expiration of the patent, were executed during the life of the '546 patent. The leases make no specific reference to any patent rights and do not contain provisions which modify any of their terms and conditions as they relate to any period beyond the expiration of the patent.

Plaintiff has consistently through the life of the patent and thereafter refused to sell Reddies machines

and has consistently followed a policy and practice of leasing the machines.

Redmond admits that the enforcement of the "no copying-no inspection" provision of the lease agreement will delay the production of a substantially identical processing machine a minimum of six months and may prevent the successful manufacture of such a machine.

The poundage rental based on use enabled plaintiff to obtain higher revenues from larger Reddies processors. A fixed price would have enabled a larger processor to spread the poundage rental cost over the larger volume processed, thereby reducing the per unit cost. This lower per unit cost would have benefited larger volume Reddies processors under a fixed price to the detriment of smaller processors. These benefits were almost entirely retained by plaintiff under the poundage rental contained in Redmond's leases.

Plaintiff initially established the rental rate for "R" series machines at 1 cent per pound. In approximately 1970, a rent escalation clause using the Consumer Price Index was incorporated for "A" series leases. The leases at issue contain such a clause.

Competition between portion controlled packages of butter is focused on the end-user level; e.g., diners and cafeterias. To serve the needs of these end-users, food service warehouses typically purchase a number of types of portion controlled packages of butter. A butter processor would not be

able to offer the food service warehouses a full line of butter packages without a source of supply of Reddies.

During the negotiations leading up to the signing by Beatrice of April 1, 1980 R-21 and R-61 leases with plaintiff, neither patents nor patent rights were discussed or mentioned. James Hill, who supervised the negotiation of the leases on behalf of Beatrice, testified in his deposition:

> "I don't know of any reason why I would care whether they had patents or not on the thing. I was only concerned about what the machine would do and the poundage it would produce and how much it cost me to run it."

There is no evidence concerning plaintiff's consideration on this subject. Nor is there any evidence concerning plaintiff's offering to sell a Reddies machine to Beatrice or Beatrice requesting to purchase a Reddies machine from plaintiff.

Sanford Redmond testified that no one ever raised with him nor does he have knowledge of anyone ever raising an issue or objection to the no inspection, no copying clause of the leases in issue.

Redmond also testified that prior to the time the subject leases were negotiated, other Reddies machines were operated at Beatrice on a month to month basis after their respective leases had expired.

> There was no discussion of a month to month term for the subject machines.

In Brulotte v. Thys Co., 379 U.S. 29, 32 (1964), the Supreme Court held that the use of a patent to obtain a royalty agreement that extends beyond the life of the patent is unlawful per se. The Court in Brulotte cited two provisions in the agreement as evidence of abuse of the leverage created by the patent monopoly: first, the royalty payments were the same before and after the expiration of the patent; and second, the agreement placed restrictions on the assignment and removal of the machines incorporating the patented technology that continued beyond the life of the patent.

This Court has previously recognized the per se illegality of such an agreement.

> A patent holder cannot use the grant of a license as means of extending the lawful term of the patent monopoly. A "patentee's use of a royalty agreement that projects beyond the expiration date of the patent is unlawful per se." [quoting Brulotte] The use of such an arrangement constitutes patent

> misuse even in the absence of evidence demonstrating that the patent holder used the leverage of the patent coercively to impose an extended term on the licensee.

Leesona Corporation v. Varta Batteries, Inc., 522 F. Supp. 1304, 1342 (S.D.N.Y. 1981).

Several Courts of Appeals have refused to separate the potentially lawful from the unlawful in contracts where there is evidence of market power leverage arising from the patent which permitted the patentee to dictate contract terms extending beyond the life of the patent. [1] See generally Pitney Bowes, Inc. v. Mestre, 701 F.2d 1365, 1371 (11th Cir.) cert. denied, 464 U.S. 893 (1983); Boggild v. Kenner Products, 776 F.2d 1315, 1319 (6th Cir. 1985) cert denied, 477 U.S. 908 (1986); and Meehan v. P.P.G. Industries, Inc.,

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[1] Plaintiff cites Universal Gym Equipment, Inc. v. ERWA Exercise Equipment Ltd., 827 F.2d 1542 (Fed. Cir. 1987), for the proposition that a contract may lawfully restrict the copying of trade secrets contained in a device which is also the subject of a patent. The patent at issue in Universal was still valid at the time of the decision, and the court in that case did not consider the question of whether a patent holder may lawfully enforce a contractual provision relating to a patented device extending beyond the life of the patent.

802 F.2d 881, 885 (7th Cir. 1986) cert denied, 479 U.S. 1091 (1987).

In this case, Redmond's '546 patent was the leverage for its non-negotiable leases. Plaintiff attempts to place some significance on the fact that the word "patent" was not used in the Lease. Neither were the words "trade secrets." In the Court's view, the leases at issue, which permitted the use of patented machines and provide for poundage rental, constitute at least an implied license.

Plaintiff first obtained the '546 patent, then made the machines available on non-negotiable terms and conditions that would not likely have been obtainable without the patent excluding competition. Until approximately 1985, butter processors either leased a machine from plaintiff or obtained from another butter processor the output of a machine leased from plaintiff, or were unable to offer a full line of butter packages. The use of the patent, therefore, to obtain an agreement for payment of compensation beyond the

expiration of the patent renders the agreement unlawful per se.

Plaintiff argues that even if the rental provisions are unenforceable after the patent expires, the no copying provision is severable and enforceable. In support of its position, plaintiff points to identical severability clauses in the two contracts at issue. As noted above, the agreement is unlawful per se. Accordingly, the entire contract — including both the no copying provision and the severability clause — is unenforceable. This is the law in this district, see Glen Manufacturing, Inc. v. Perfect Fit Industries, Inc., 299 F. Supp. 278, 282-83 (S.D.N.Y. 1969), reversed on other grounds, 420 F.2d 319 (2d Cir.), cert. denied, 397 U.S. 1042 (1970), on remand, 324 F. Supp. 1133 (S.D.N.Y. 1971), and in the State of New York, see Noto v. Satloff, 38 Misc. 2d 915, 239 N.Y.S.2d 324 (1963); American Store Equipment & Construction Corp. v. Jack Dempsey's Punch

Bowl, Inc., 174 Misc. 436, 21 N.Y.S.2d 117 (1939) aff'd, 283 N.Y. 601 (1940).

As explained by the New York Court of Appeals in Turner v. Wilson, 50 N.Y.2d 59, 427 N.Y.S.2d 977, 405 N.E.2d 220 (1980): "Such clauses [i.e. severability clauses] are not to be taken to render specific provisions independently enforceable when an agreement itself, rather than any of its components, is brought to an end." Id. at 427 N.E.2d at 223.

Upon the expiration of the '546 patent the only obligation which remained was the obligation to return the machines to Redmond. Accordingly, plaintiff's contract claim as well as its trade secret claim are dismissed. Defendant is awarded costs.

The foregoing constitute the findings of fact and conclusions of law of the Court for the purposes of Rule 52, Fed. R. Civ. P.

It is so ordered.

Dated: New York, New York
March 3, 1992

/s/ Robert J. Ward
U.S.D.J.

APPENDIX C

SUPREME COURT OF THE UNITED STATES

No. A-18

Sanford Redmond, Inc.,

Petitioner

v.

Mid-America Dairymen, Inc.

ORDER

UPON CONSIDERATION of the application of counsel for the petitioner,

IT IS ORDERED that the time for filing a petition for a writ of certiorari in the above-entitled case, be and the same is hereby, extended to and including August 25, 1993.

/s/ Clarence Thomas
Associate Justice of the Supreme
Court of the United States

Dated this 7th
day of July, 1993.

APPENDIX D

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

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SANFORD REDMOND, INC.,	:	
Plaintiff,	:	
- against -	:	STIPULATED FINDINGS OF FACT
MID-AMERICA DAIRYMEN, INC.,	:	85 Civ. 4574 (RJW)
Defendant.	:	

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PLAINTIFF'S CONTRACT CLAIM

On April 21, 1964 plaintiff Sanford Redmond, Inc. ("Redmond") obtained a patent on a machine that processed "Reddies", a portion controlled package of butter or margarine (the "546 patent"). As far as the Court has been made aware, all Reddies type packages of butter produced by mechanized means were processed on machinery manufactured by Redmond until approximately 1985.

According to Sanford Redmond, no patent has ever been applied for or obtained on the Reddies package nor has any trademark for said package ever been applied for or registered by plaintiff.

Sanford Redmond also states that the cost of manufacturing the "R" series machine in 1980 was approximately $200,000.

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The leases between plaintiff and the Sugar Creek Foods Division of Beatrice Foods Co. ("Beatrice") which defendant assumed in August 1983 after the expiration of the patent, were executed during the life of the 546 patent. The leases make no specific reference to any patent rights and do not contain provisions which modify any of their terms and conditions as they relate to any period beyond the expiration of the patent.

Plaintiff has consistently through the life of the patent and thereafter refused to sell Reddies machines and has consistently followed a policy and practice of leasing the machines.

Redmond admits that the enforcement of the "no copying-no inspection" provision of the lease agreement will delay the production of a substantially identical processing machine a minimum of six months and may prevent the successful manufacture of such a machine.

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Redmond also testified that prior to the time the subject leases were negotiated, other Reddies machines were operated at Beatrice on a month to month basis after their

respective leases had expired. There was no discussion of a month to month term for the subject machines.

Dated: New York, New York
December 18, 1991

KAGEL & STEINER
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/s/ Leonard Steiner, Esq.
Leonard Steiner, Esq.
Attorney for Plaintiff